

Press Release

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Northern Rock – Some Questions

The UK Shareholders Association (UKSA) believes that there are a number of questions that need to be answered about the debacle of Northern Rock. For example, one of our members purchased shares in the region of 700p after they had already fallen from over 1200p during the preceding months. At that level they seemed good value. In early September there were numerous press mentions about rumours of further profit warnings, but nothing was issued by the company. No news usually means good news as the company has an obligation to disclose price sensitive information. On the 13th September the share price fell from 672p to 639p during the day, but still no news (does this suggest some inside trading we wonder). On the morning of the 14th September the company issued the fateful announcement that it had received promise of support from the Bank of England to meet its funding needs. This announcement had three consequences:

1. It caused depositors to panic and generated a typical “run” on the bank – not seen in England for the last 100 years. Instead of reassuring investors and depositors, it made matters worse.
2. It made it clear that other bankers were unwilling to lend Northern Rock the apparent small amount of funds required at any price. Conclusion from investors: either Northern Rock’s problems were much more severe than the Company was indicating, or bankers simply did not have the cash to lend – with implications for the rest of the financial world.
3. The outlook for the business was probably much worse than indicated by the nominal profit forecasts in the announcement because the Bank of England’s conditions for support were expensive, and the withdrawal of depositors’ funds would compound the Company’s difficulties.

The result was a further fall in the share price, down to 438p on the day, and 282p on the following Monday as the depositors panic clearly worsened. As we said to the media on that day, there seemed little option now except for the Company to put itself up for sale as the business was likely to be destroyed by the negative reputational impact. People neither want to deposit money with, or borrow, from a bank when its financial stability is uncertain. But as we saw with Torex Retail, a “fire sale” typically results in a poor price to the selling shareholders.

So the directors of Northern Rock should surely account for their failure to anticipate the funding problems. Questions also need to be asked why investors were not told at an earlier stage about the nature of the problems, and about whether the wording of the fateful announcement on the 14th September that caused both depositors and investors to panic contributed to the crisis.

It also raises the question of whether bank regulation is adequate to avoid a repetition of these circumstances in other banks or building societies. Clearly borrowing short term money to fund long term lending such as mortgages can be hazardous even when financial markets are relatively calm. But the money markets being used by Northern Rock as a major source of funding seem even more fickle than retail depositors so perhaps the rules governing levels of capital adequacy for such institutions should be reviewed.

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About The UK Shareholders Association (UKSA)

UKSA is the leading independent organisation which represents the interests of private shareholders in the United Kingdom. We campaign to protect the rights of shareholders in public companies, and to promote improved standards of corporate governance. Our educational activities, regular regional meetings, company “analyst” meetings and the resources of our web site, help to inform the public on investment management. UKSA is a “not for profit” organisation which is financially supported primarily by its individual members.